

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

**Telecommunications Division  
Market Structure Branch \*\***

**RESOLUTION T-16572  
October 25, 2001**

**R E S O L U T I O N**

RESOLUTION T-16572. VERIZON CALIFORNIA, INC. (U-1002-C).  
ORDER ACCEPTING, SUBJECT TO ANY ADJUSTMENTS OR  
CORRECTIONS RESULTING FROM THE NRF AUDIT, VERIZON'S  
ANNUAL RATE OF RETURN ADVICE LETTER FILING MADE IN  
COMPLIANCE WITH DECISION 98-10-026.

BY ADVICE LETTER NO. 9728 FILED ON APRIL 2, 2001.

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**SUMMARY**

This Resolution accepts Verizon California, Inc.'s (Verizon) annual rate of return advice letter filing subject to any corrections or adjustments to the reported rate of return that may be appropriate as a result of the NRF audit.

Since sharing has been suspended in Decision (D.) 98-10-026, there is no impact on rates as a result of this filing.

**BACKGROUND**

**New Regulatory Framework (NRF)**

Decision 98-10-026, resulting from the third triennial NRF review, adopted the suspension of sharing effective January 1, 1999, continued the requirement for the reporting of rates of return, phased out existing Z factor adjustments and eliminated new Z factor adjustments, and included a provision for the consideration of only a very limited set of exogenous costs, and the continued rate caps and floors.

**VERIZON'S ANNUAL RATE OF RETURN FILING**

Pursuant to D. 98-10-026 Verizon filed its Annual Rate of Return advice letter, which is to be filed every April 1 for the purpose of reporting its rates of return and the market-

based, benchmark, ceiling, and floor rates of return last found reasonable. In this filing Verizon reported an annual rate of return (ROR) for the year 2000 of 10.97%. Other references reported in Verizon's filing included the following rates of return:

Market-Based	10.50%
Benchmark	12.00%
Ceiling	15.50%
Floor	7.75%

### **NOTICE/PROTESTS**

Verizon states that a copy of Advice Letter No.9728 had been mailed to interested utilities and/or parties. Notice of Advice Letter No.9728 was noticed in the Commission's Daily Calendar of April 6, 2001.

The Commission's Office of Ratepayer Advocates (ORA) filed a timely protest to this advice letter on April 23, 2001. ORA asserts that a determination of Verizon's actual ROR would be premature without ORA's analysis of supporting workpapers, which had not been received as of the writing of this resolution, and without the findings from the ORA NRF audit.

Verizon filed a timely response to ORA's protest on May 1, 2001. Verizon contends that the year 2000 is outside the scope of the NRF audit, and points out the several options available to the Commission regarding the NRF audit reports. Verizon believes that impact of the audit report is unknown.

Regarding ORA's observation that Verizon's ROR varies considerably between 1999 and 2000, Verizon contends that the high ROR in 1999 was due to an error in recording pension activity and that they intend to revise the 1999 results accordingly. This is also somewhat contradictory since Verizon stated in its response to ORA protest (p. 2): "Verizon's year 2000 earnings report is based on actual results as recorded on its books of account and there is no basis to reject it as premature." Whereas on the same page Verizon states "...In 1999, a portion of the pension activity was booked inappropriately ... Correctly recording this activity will reduce the 1999 return by approximately 290 basis points." A footnote indicates that Verizon intends to revise its 1999 results.

Verizon also asserts that since sharing was suspended, and is to be considered for permanent elimination in the next NRF review, any discussion of sharing in this filing is inappropriate.

## **DISCUSSION**

D. 98-10-026 suspended sharing and reduced the annual sharable earnings filing to an information only type of report. Had it not been suspended the sharing resulting from this filing would have been \$0. Verizon has filed this advice letter within that context. In the forthcoming 4<sup>th</sup> triennial NRF review, it is expected that the Commission will address, among other things, the issue of suspended sharing, as well as the results from the NRF audit. It is possible that the outcome of the Commission's examination of the NRF rules and audit results could have an effect on the year 2000 results of operations. In order to preserve the Commission's options during the NRF review, Verizon's reported ROR will be accepted subject to any corrections or adjustments that may be appropriate as a result of the NRF audit.

## **COMMENTS ON DRAFT RESOLUTION**

The draft resolution was mailed to parties in accordance with Public Utilities Code Section 311(g)(1). Comments were received from ORA on September 19, 2001 and from Verizon on September 26, 2001. No other comments were received. No replies were received.

ORA strongly recommends that the Commission adopt the TD's draft resolution T-16572. ORA points out that the Commission has recently issued OIR 01-09-001/OII 01-09-002 (NRF OIR/OII) on September 6, 2001 & that ORA's audit report on Verizon was issued on April 30, 2001. ORA believes that depending on the findings and/or corrective measures adopted by the Commission in the NRF OIR/OII the results presented in the audit report could have an impact on Verizon's year 2000 return. It was further pointed out that parties were asked to identify audit findings that are relevant to Phase 3 issues, where it will be determined if or the extent to which NRF should be revised.

In its comments to the draft resolution, Verizon recommends that the draft resolution be revised to eliminate the "subject to refund" provision for three reasons: (1) it would violate the Commission's order in the last triennial review, (2) because of the prohibition against retroactive ratemaking, and (3) because of the filed rate doctrine. Verizon suggests that the DRAFT Resolution should accept Verizon's 2000 earnings report subject to any corrections or adjustments that may be appropriate as a result of the NRF audit.

Verizon claims the “subject to refund” provision is “fatally flawed” the ban against retroactive ratemaking, as well as prohibitions against charging any rates other than those on file with the Commission.

Verizon states that the Draft Resolution positions the Commission with advocating two conflicting courses of action: suspending sharing and holding rates to be just and reasonable, while at the same time ordering reported earnings to be subject to refund. Verizon concludes that these courses of action are irreconcilable. In essence, Verizon’s position states that its rates were found to be just and reasonable during the Third Triennial NRF Review and cannot be subject to refund, even if adjustments to its reported earnings were found to be necessary. According to Verizon, the fact that sharing has been suspended is an insurmountable hurdle to the ordering of a refund:

“The Commission cannot suspend earnings sharing and find rates to be just and reasonable, and, at the same time order reported earnings to be held “subject to refund” pending the outcome of the new NRF review.”

Verizon responds to ORA’s comments (since ORA filed its comments early) with the charge that ORA has expanded its request beyond its call to reject the advice letter, and that no legal basis was provided for the proposal.

As further support for its position that the 2000 sharable earnings filing should not be accepted with a subject to refund condition, Verizon cites its reply to ORA’s protest wherein it was stated “...that, even if adjustments were made to its reported earnings as a result of ORA’s audit report, customer rates would not be affected because earnings sharing had been suspended by the Commission.”<sup>1</sup>

Verizon also believes that the draft resolution incorrectly states that Verizon agrees with ORA that the audit results could possibly impact the year 2000 earnings, but that such impact is unknown at this time. Verizon states that its position is that it acknowledges only that the impact of the audit report was unknown.

#### DISCUSSION OF COMMENTS ON DRAFT RESOLUTION

Verizon is correct that in the 3<sup>rd</sup> Triennial NRF Review the Commission suspended sharing, indicating that it would consider whether to permanently eliminate, reinstate, or modify it in a future NRF review, the Commission continued to require Verizon and Pacific Bell to file annual earnings reports for reference purposes.

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<sup>1</sup> Verizon also disagrees with the draft resolution characterization of Verizon as seemingly agreeing with ORA that the audit results could possibly impact the year 2000 earnings.

We shall accept Verizon's 2000 rate of return advice letter filing subject to any corrections or adjustments to the reported rate of return which may be appropriate as a result of the NRF audit.

The language in the draft resolution stated that Verizon seemed to agree with ORA that the audit results could possibly impact the year 2000 earnings, but that such impact is unknown at this time. The language is changed to reflect Verizon's position that it acknowledged that the impact of the audit report was unknown.

## **FINDINGS**

1. Advice Letter 9728 was filed in a timely manner.
2. It included the specified information required.
3. Confidential cost support was included in the filing.
4. A timely protest to this advice letter was filed by ORA.
5. ORA had requested, but not yet received, explanations regarding the significant differences between the intrastate and interstate returns. GTEC's Interstate Return for the year 2000 is reported at 25.12%, while the Intrastate Return is only 10.97%, a difference of 229.0%.
6. ORA pointed out that a NRF audit is currently being conducted by the ORA for evaluation in the 4<sup>th</sup> triennial NRF review.
7. The cost support supplied by Verizon with this filing ties into the reported Rate of Return.
8. The 4<sup>th</sup> triennial NRF review could possibly result in significant effects on Verizon's reported earnings for the record period of 1996 through 1998.
9. Such effects could carry over into the year 2000's reported earnings.
10. The reference RORs are as follows:
  - Market-Based – 10.5%
  - Ceiling – 15.5%
  - Floor – 7.75%
11. Sharing is currently suspended. Had there been sharing the calculated amount would have been \$0.
12. An audit of the Company's books and records for the record period of 1996 through 1998, as currently being conducted, is expected to be included in the next NRF review.
13. The future of sharing (i.e. continued suspension, permanent elimination, reinstatement, or some other modification) is slated as an issue for the next NRF review.

**THEREFORE IT IS ORDERED THAT:**

1. Verizon's annual rate of return advice letter reporting its rate of return for the year 2000 shall be accepted subject to any corrections or adjustments to the reported rate of return which may be appropriate as a result of the Commission's findings in the upcoming NRF review.

This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on October 25, 2001. The following Commissioners approved it:

/s/ WESLEY M. FRANKLIN

WESLEY M. FRANKLIN

Executive Director

LORETTA M. LYNCH

President

HENRY M. DUQUE

RICHARD A. BILAS

CARL W. WOOD

GEOFFREY F. BROWN

Commissioners